

State of Montana
COMPREHENSIVE ANNUAL FINANCIAL REPORT
For the Fiscal Year Ended June 30, 2008

Prepared By:

Department of Administration

Janet Kelly, Director

Sheryl Olson, Deputy Director

State Accounting Division

Paul Christofferson, CPA, Administrator

Accounting Bureau

Julie Feldman, Bureau Chief

Accounting Principles/Financial Reporting Section

Janet Atchison, Accountant

Wendy Feth, Accountant

Gina Huffman, Accountant

Charles Idehen, CPA

Operations Section

Mark Curtis, Computer Applications Software Engineer

State of Montana
COMPREHENSIVE ANNUAL FINANCIAL REPORT
For the Fiscal Year Ended June 30, 2008

Table of Contents

INTRODUCTORY SECTION

	Page
Title Page	1
Table of Contents	2
Letter of Transmittal	6
Certificate of Achievement for Excellence in Financial Reporting	11
State Organization Chart.....	12
Selected State Officials.....	13

FINANCIAL SECTION

Independent Auditor's Report	16
Management's Discussion and Analysis	20

Basic Financial Statements

Government-wide Financial Statements	
Statement of Net Assets.....	32
Statement of Activities	34

Governmental Fund Financial Statements	
Balance Sheet	38
Reconciliation of Balance Sheet – Governmental Funds to the Statement of Net Assets	39
Statement of Revenues, Expenditures, and Changes in Fund Balances	40
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds to the Statement of Activities.....	42

Proprietary Fund Financial Statements	
Statement of Net Assets.....	46
Statement of Revenues, Expenses, and Changes in Fund Net Assets.....	48
Statement of Cash Flows	50

Fiduciary Fund Financial Statements	
Statement of Fiduciary Net Assets	54
Statement of Changes in Fiduciary Net Assets.....	55

Component Unit Financial Statements	
Combining Statement of Net Assets.....	58
Combining Statement of Activities	60

Notes to the Financial Statements	
Note 1 – Summary of Significant Accounting Policies	62
Note 2 – Other Accounting Issues	69
Note 3 – Cash/Cash Equivalents and Investments.....	69
Note 4 – Disaggregation of Accounts Receivable and Payable.....	81
Note 5 – Capital Assets	83
Note 6 – Retirement Plans	86
Note 7 – Other Postemployment Benefits	96
Note 8 – Risk Management	100

Notes to the Financial Statements (<i>continued</i>)	
Note 9 – Commitments	108
Note 10 – Leases/Installment Purchases Payable	109
Note 11 – State Debt	110
Note 12 – Interfund Balances and Transfers	118
Note 13 – Fund Deficits	121
Note 14 – Reserved Fund Balances	121
Note 15 – Related Party Transactions	121
Note 16 – Contingencies	122
Note 17 – Subsequent Events	126
Note 18 – Material Violations of Finance-Related Legal Provisions	127

Required Supplementary Information

Budgetary Comparison Schedule – General and Major Special Revenue Funds	130
Notes to the Required Supplementary Information – Budgetary Reporting	132
Pension Plan Information – Schedule of Funding Progress	133
Notes to the Required Supplementary Information – Other Postemployment Benefits Plan Information	134
Other Postemployment Benefits Plan Information – Schedule of Funding Progress	134

Supplementary Information – Combining Statements and Individual Fund Statements and Schedules

Nonmajor Governmental Funds	
Combining Balance Sheet – Governmental Funds by Fund Type	136
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds by Fund Type	137
Combining Balance Sheet – Debt Service Funds	140
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Debt Service Funds	142
Combining Balance Sheet – Capital Projects Funds	146
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Capital Projects Funds	147
Combining Balance Sheet – Permanent Funds	150
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Permanent Funds	152
Proprietary Funds	
Nonmajor Enterprise Funds	
Combining Statement of Net Assets	156
Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets	164
Combining Statement of Cash Flows	168
Internal Service Funds	
Combining Statement of Net Assets	178
Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets	182
Combining Statement of Cash Flows	186
Fiduciary Funds	
Pension (and Other Employee Benefit) Trust Funds	
Combining Statement of Fiduciary Net Assets	196
Combining Statement of Changes in Fiduciary Net Assets	198
Private-Purpose Trust Funds	
Combining Statement of Fiduciary Net Assets	202
Combining Statement of Changes in Fiduciary Net Assets	204
Agency Funds	
Combining Statement of Fiduciary Net Assets	208
Combining Statement of Changes in Assets and Liabilities	210

STATISTICAL SECTION

Index to the Statistical Sections	213
Schedule A-1 – Net Assets by Component	214
Schedule A-2 – Change in Net Assets	216
Schedule A-3 – Fund Balances, Governmental Funds	220
Schedule A-4 – Changes in Fund Balances, Governmental Funds	222
Schedule B-1 – Personal Income by Industry	224
Schedule B-2 – Personal Income Tax Rates	225
Schedule B-3 – Personal Income Tax Filers and Liability by Income Level	226
Schedule C-1 – Ratios of Outstanding Debt by Type	227
Schedule C-2 – Pledged Revenue Coverage	228
Schedule C-3 – Ratios of General Bonded Debt Outstanding	234
Schedule D-1 – Demographic and Economic Statistics	235
Schedule D-2 – Principal Employers	236
Schedule E-1 – Full-Time Equivalent State Employees by Function/Program	238
Schedule E-2 – Operating Indicators by Function/Program	240
Schedule E-3 – Capital Asset Statistics by Function/Program	244

INTRODUCTORY SECTION



DEPARTMENT OF ADMINISTRATION STATE ACCOUNTING DIVISION



BRIAN SCHWEITZER, GOVERNOR

MITCHELL BUILDING
HELENA, MT 59620-0102

STATE OF MONTANA

Accounting Bureau
Rm. 255
PO Box 200102
(406) 444-3092

SABHRS Finance and Budget Bureau
Rm. 270
PO Box 200102
(406) 444-5700

Treasury Unit
Rm. 261
PO Box 200140
Helena, MT 59620-0140
(406) 444-2624

Local Government
Services Bureau
301 S. Park, Rm. 340
PO Box 200547
Helena, MT 59620-0547
(406) 841-2909

December 12, 2008

To the Citizens, Governor, and Members of the Legislature of the State of Montana:

In accordance with Title 17, Chapter 2, Part 110, Montana Code Annotated (MCA), we are pleased to submit the Comprehensive Annual Financial Report (CAFR) of the State of Montana for the fiscal year ended June 30, 2008. Responsibility for the accuracy of the data presented and the completeness and fairness of the presentation rests with the Department of Administration. To the best of our knowledge and belief, the enclosed data are accurate in all material respects, and are reported in a manner designed to present fairly the financial position and results of operations of the various funds of the State of Montana. All disclosures necessary to enable the reader to gain an understanding of the State's financial activities are included.

DESCRIPTION OF THE CAFR

This report and the accompanying financial statements and statistical tables were prepared in accordance with standards set forth by the Governmental Accounting Standards Board (GASB).

This CAFR is divided into three main sections: introductory, financial, and statistical. The introductory section includes this transmittal letter, an organization chart for the State, and a table of contents. The financial section contains management's discussion and analysis, the independent auditor's report, government-wide financial statements, fund financial statements, notes to the financial statements, combining statements by fund type, and other schedules. The statistical section includes financial, economic, and demographic data.

This report includes all funds of those entities that comprise the State of Montana (the primary government) and its component units. The component units are entities that are legally separate from the State, but for which the State is financially accountable, or whose relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body; and (1) the State is able to impose its will on that organization; or (2) there is the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the State. The following component units are included in the State's financial reporting entity: Housing Authority, Facility Finance Authority, State Compensation Insurance Fund (Old and New), Montana State University, University of Montana, Public Employees Retirement Board, and Teachers Retirement System. These component units are discretely presented in the State's financial statements.

PROFILE OF THE GOVERNMENT

Montana became the 41st state when it was admitted to the Union in 1889, 25 years after the attainment of territorial status. With an area of 145,552 square miles, Montana is the nation's fourth largest state. With an estimated population of 957,861, it is also one of the nation's most sparsely populated states. It is a vast land: a land including rolling plains, the Northern Rocky Mountains, two national parks, wheat farms and cattle ranches, tribal lands, and extensive natural resources.

In 1972, a constitutional convention convened, rewriting the State's constitution and establishing the current governmental structure. As shown in the organizational chart on page 12, state government is divided into three

separate branches: legislative, executive, and judicial. Montana's Legislature consists of 50 senators and 100 representatives elected from single-member districts. The Legislature meets in regular biennial sessions for 90 days in odd-numbered years. Montana is governed by its constitution, and its laws are administered by its executive branch officers and various boards and commissions. State government services provided to citizens include building and maintaining roads; providing public safety, health, and environmental protection services to protect the general welfare of the State's citizens; helping adults, children, and families through difficult times such as abuse, divorce, illness, death, and unemployment; fostering an attractive business climate to encourage economic growth; and protecting public lands and natural resources for conservation and recreational activities. The State also provides significant financial support to its higher education institutions, local governments, and school districts to help those entities meet the specific needs of their constituents.

ECONOMIC CONDITION AND OUTLOOK

Montana's economic base remains concentrated in agriculture, mining, wood products and other manufacturing, nonresident travel, and government. Montana's economy continued to grow through the end of calendar 2007. This growth rate slowed during the first two quarters in 2008 with job losses in the natural resources and mining, construction, financial activities, and professional and business services industries. As of August, these losses had been offset by increases in the manufacturing, trade/transportation/utilities, information, education and health services, leisure and hospitality services, and other services industries. Overall, Montana's economy is still growing, but the signals are mixed with the current estimated growth rate for Montana's economy in calendar year 2008, as of the end of August, estimated at 3.8%. Through October 2008, employment has grown 1.5%. Montana's income tax revenues increased for fiscal year 2008 primarily as a result of this continued internal income growth. Montana corporate income tax revenues declined in fiscal year 2008 as a result of the national economic downturn. This decline is expected to continue into fiscal year 2010. For a more in-depth analysis of the impact of this growth on the State's financial position, the reader should refer to management's discussion and analysis and the financial statements contained in the CAFR.

Montana's wheat yields increased in 2008, with production projected to reach 164.7 million bushels, compared to the 2007 production level of 149.8 million bushels. Winter wheat yields rose to 94.4 million bushels, 13% higher than the 2007 level. Spring wheat yields reached 59.5 million bushels, up 8% from 2007. Durum production is estimated at 10.8 million bushels, down 5 percent from 2007. The increase in winter wheat production was primarily due to the seeding of more acres. Actual yield per acre of winter wheat seeded was up slightly, by 1 bushel an acre, in 2008. The increase in spring wheat was due to a combination of seeding more acres and the slightly increased yields. Durum producers seeded more acreage and obtained 5 bushels less per acre than in 2007. Wheat prices have been lower in 2008, falling in the \$6.55 to \$7.15 per bushel range, reflecting the impacts of higher U.S. and worldwide production, combined with the global economic downturn.

Montana's other major agricultural commodities include oats, barley, and cattle. Oat production in Montana decreased to an estimated 1.5 million bushels in 2008, representing a 16% decrease from 2007 levels. Barley production is estimated at 37.7 million bushels, which is 19% higher than last year. Montana's cattle herd increased in 2008 to an estimated 2.6 million head. Montana ranks eleventh in the U.S. cattle and calf industry. Montana's 2007 receipts from cattle sales exceeded \$1.0 billion.

As of the end of calendar year 2007, Montana's manufacturing sector improved for a fourth consecutive year. Employment in this industry remained strong, with 24,400 workers employed at the end of 2007. Employee earnings in the manufacturing industry increased to over \$1.1 billion in 2007. The manufacturing sector sales remained at \$8 billion and still accounts for 20% of Montana's economic base. Production, sales, and earnings were up in 2007, as a result of the strong global economy and strong economies within Montana and the surrounding states. For comparison purposes, the above information does not include the logging industry, as it did previously. The logging industry provides an additional 2,500 jobs and \$109 million in labor income. To date in 2008, the number of manufacturing jobs remains basically unchanged, with a very slight increase of 100 jobs, through August.

As a result of the decline in the housing market, prices for lumber and other wood products were lower in 2007. The price decreases, coupled with the unavailability of raw materials, has led to a continuing decline in production. With

production around 516 million board feet for the year, the timber harvest was the lowest since 1952. Estimated total sales value of the State's primary wood and paper products in 2007 was \$980 million, down about \$90 million from 2006. The total wood products industry estimated employment of 9,700 workers for 2007 was lower than the estimated 2006 level of 10,300. Montana's estimated lumber production dropped from about 940 million board feet in 2006 to 805 million board feet in 2007. The first three quarters of 2008 lumber production level is 553 million board feet, and represents a 51 million board feet decrease over the same period in 2007.

Nonresident travel to Montana in 2007 increased an estimated 2.9% to approximately 10.7 million visitors. The visitor numbers for Yellowstone and Glacier national parks were up. Yellowstone Park, with 2.1 million visitors, posted an 8.2% increase, and Glacier Park saw 2.1 million visitors, which represents a 6.1% increase. Montana's state park system received 1.9 million visits, 3% more than those in 2006. Motel occupancy posted an increase of 4.3% over the 2006 levels. Nonresident travelers contribute to the tax base by paying the lodging tax; excise taxes, such as those on gasoline; and indirectly, by supporting employment in industries that pay corporate taxes and whose workers pay income property, and other taxes. Estimated non resident travel expenditures in Montana totaled \$3.1 billion in 2007. The direct economic impact of nonresident travel is estimated at \$3 billion. When combined with the indirect and induced economic benefits, the economic benefit of nonresident travel on Montana should remain at approximately \$4.3 billion. Current estimates indicate that the travel industry will continue to increase by approximately 2% in 2008.

An estimated 410 million barrels of proven oil reserves exist under Montana's land. In 2007, due to the maintenance of high crude oil and natural gas prices, the State saw a continuation of production and exploration activity, with estimated crude oil production for the state at 34.9 million barrels. This translated into a positive economic impact for the State as a whole and a much needed economic benefit for eastern areas of the State. While the price of crude oil has dropped significantly in 2008, as of August, the lower crude oil price had not caused a corresponding drop in oil production within the State.

Historically, metals mining has been a significant part of Montana's economy. While there is no published data on proven reserves for metals mining, Montana has produced copper, molybdenum, lead, zinc, palladium, gold, silver, nickel, chromate, and other metals. The State currently has seven active metals mines producing primarily palladium, platinum, copper, molybdenum, gold, silver, lead, and zinc. These active mines employ approximately 2,700 employees. Lower mineral prices, regulatory and siting issues, a shortage of experienced workers, unavailability of mining supplies, unavailability of venture capital, in addition to the high cost of the fuel and power required to extract these metals, has impacted the potential future development in metals mining within the State.

Montana's total coal reserves were estimated at 119,123 million short tons with recoverable reserves of 74,856 million short tons in 2007. This represents 24% of the total, and 28% of the recoverable, reserves in the U.S. Of these reserves 1,251 million short tons of coal are at producing mine sites. During 2007, Montana's coal production increased to 43,390 thousand short tons, an increase of 3.7%. The development of a coal-to-liquids plant in Montana is still under consideration. If successfully developed, this will represent a move toward the development of value-added processing of coal within the State. Additionally, the permitting process is complete for construction of the first new major power transmission line in Montana since the 1970s. While this power transmission line is primarily intended for transmission of wind generated electricity, it will also be available to carry electricity generated from other sources, including coal.

MAJOR INITIATIVES

In fiscal year 2008, the General Fund unreserved, undesignated fund balance increased over projections. The increase was primarily due to higher than expected revenues. Individual income, property, and oil and natural gas production taxes exceeded revenue forecasts.

The 60th Legislature approved budgetary increases including: a property tax refund program; a 3.06% salary increase for state employees, increases in the K-12 educational contributions, increases in higher education transfers; higher children's health insurance payments, an income tax credit, and significant capital improvement programs.

Both the increased revenue and budgeted expenditures are discussed in more detail in the managements discussion and analysis included in this report.

FINANCIAL INFORMATION

Montana's Statewide Budgeting, Accounting, and Human Resource System (SABHRS) is a centrally maintained, fully computerized, double-entry accounting system. SABHRS records are computer-edited.

Management of the State is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss or misuse, and that adequate accounting data are compiled to allow for the preparation of financial statements in accordance with generally accepted accounting principles. In developing and evaluating the State's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance that the above objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived, and that the evaluation of costs and benefits requires estimates and judgments by management.

Budgetary restrictions are imposed via appropriations approved by the Legislature or established administratively as provided for by state law. Appropriations are required by state law for the general, state and federal special revenue, and capital projects funds. The level of budgetary control is generally established by fund. SABHRS is designed to provide budgetary control by preventing spending in excess of legislative and administrative authority and/or available cash. SABHRS also provides for encumbrance accounting as a technique for accomplishing budgetary control.

General Fund Balance

The unreserved, undesignated fund balance of the General Fund decreased from \$549.2 million at June 30, 2007, to \$433.6 million at June 30, 2008. This represents a decrease of \$115.6 million (21.0%).

Cash Management

The uniform investment program established by the 1972 Montana Constitution directs that the Board of Investments has sole authority to invest state funds. The board operates under the "prudent person principle", which requires the board to (1) discharge its duties in the same manner as that of a prudent person acting in a like capacity with the same resources and aims; (2) diversify the holdings of each fund to minimize the risk of loss and maximize the rate of return; and (3) discharge duties solely in the interest of, and for the benefit of, the funds managed. Permissible investments include bonds, notes, debentures, equipment obligations, common stock (pension trust and higher education funds only), commercial paper, bankers acceptances, interest bearing deposits in Montana financial institutions, real estate, and any other investment in a Montana business that continues existing jobs or creates new jobs. These investments are subject to statutory restrictions for quality and size of holdings.

Unless otherwise provided by law, treasury cash is pooled for investment regardless of the fund from which it is deposited, and the pool investment earnings are credited to the General Fund. The board reported total investment income from investments under its management of \$409 million, a decrease of 25% from the \$545 million earned last year. The book value of board-managed investments increased by approximately \$278 million, or 2.2%, to \$12.5 billion at fiscal year-end 2008. The board publishes an annual audited report of all its investment activity. That report may be referenced for more in-depth investment information.

Other Post Employment Benefits - Implied Rate Subsidy Liability

The State of Montana reported the "implied rate subsidy" liability, required under the Governmental Accounting Standards Board (GASB) Statement No. 45, in this financial report and the related financial statements. Although the State reported this liability, and related expenses and expenditures, the State does not agree that this represents a legal liability and further believes that the presentation of this activity in the financial statements will eventually be misleading to the users of the statements. In this, the first year of implementation, the unfunded liability is \$40.5 million for the state system, and \$17.3 million for the Montana University System, plans. Because this is spread across all of the funds within the State and MUS reporting entities, this did not yet have a material impact.

The State plans to continue funding the employee health insurance plan on a "pay as you go" basis, and does not plan to fund this liability. Because the State will not be funding this liability, it will increase exponentially, and

within a few years, the financial statements will reflect the impact of a very large “implied rate subsidy” liability that does not have legal substance. The State submitted a request to have GASB reconsider the requirement to report the implied rate subsidy. To date, GASB has refused to revisit this issue. A copy of the letter to GASB providing the State concerns with the implied rate subsidy reporting, required under GASB Statement No. 45, is available upon request.

INDEPENDENT AUDIT

The financial statements contained in Montana's Comprehensive Annual Financial Report were audited in accordance with generally accepted auditing standards by the State's Legislative Audit Division. The Legislative Auditor is appointed by and reports to the Legislative Audit Committee. The Deputy Legislative Auditor issued an unqualified opinion on the State's financial statements for fiscal year 2008.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Montana for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007. This was the eighteenth year out of nineteen years that the State received this prestigious award. In the year of the SABHRS implementation the State did not participate in the review process due to the late issuance of the related report. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current CAFR continues to conform to the Certificate of Achievement Program requirements; we are submitting it to GFOA to determine its eligibility for another certificate.

ACKNOWLEDGEMENTS

The preparation of this report on a timely basis could not be accomplished without the efficient and dedicated service of the entire staff of the Accounting Bureau and the cooperation of accounting personnel at the individual state agencies. I would like to express my appreciation to the Accounting Bureau and other agency personnel who participated in the preparation of this document. I would also like to thank the Legislature and all state agencies for their interest and support in planning and conducting the financial operations of Montana in a professionally responsible and progressive manner.

Respectfully submitted,

A handwritten signature in black ink, reading "Paul A. Christofferson". The signature is fluid and cursive, with the first name "Paul" being the most prominent.

Paul A. Christofferson, CPA, Administrator

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Montana

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2007

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



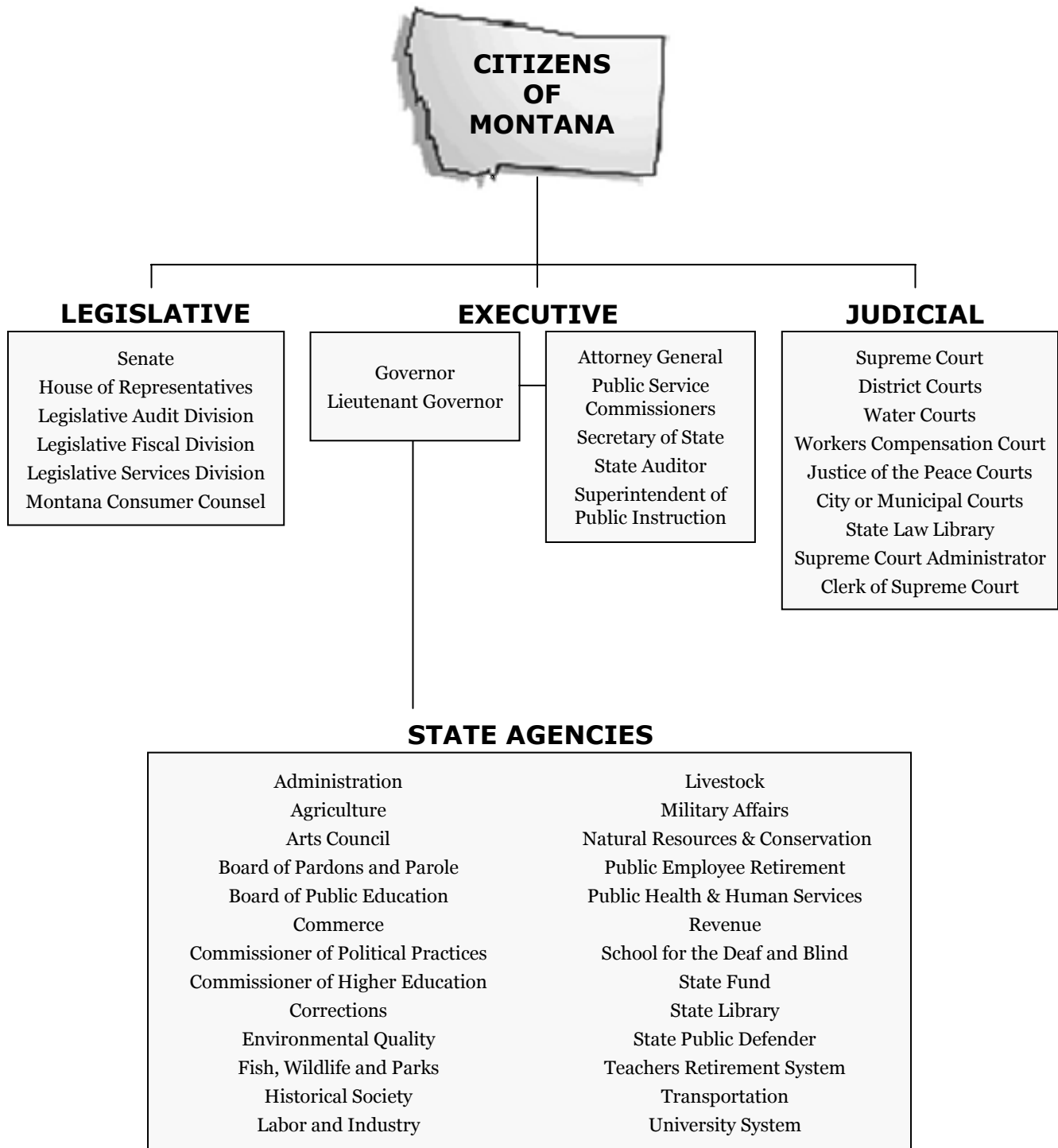
A handwritten signature in black ink, appearing to read "K. L. R.", positioned above the title "President".

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emer", positioned above the title "Executive Director".

Executive Director

STATE OF MONTANA ORGANIZATION CHART



State of Montana
SELECTED STATE OFFICIALS

EXECUTIVE

Brian Schweitzer

Governor

John Bohlinger

Lieutenant Governor

JUDICIAL

Karla Gray

Chief Justice

LEGISLATIVE

Mike Cooney

President of the Senate

Scott Sales

Speaker of the House